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ISPOSITION OF STATE-OWNED CANAL PROJECTS

Background

In 1934 the state of Montana initiated a major program to construct water projects to provide water for agriculture and to relieve depressed economic conditions across the state. The State Water Conservation Board sponsored the construction of 181 water projects. 141 projects have dams and reservoirs with a total storage capacity of 438,000 acre-feet. Associated with the dams and reservoirs are 815 miles of canals with a capacity to carry 260,000 acre-feet of water.

In the 1950's the State slowed its development of water resources, and yielded its responsibilities to the federal government from 1950 through the late 1970's. The Conceptual Plan for Montana Water Resources Projects (1978) stated that after 1960 "not only was there no new (state) construction, there was a gradual deterioration of the entire state water development system due to a number of causes including advancing age, poor initial construction practices for some projects, the inability of water users associations to finance major repairs for their projects, increasing costs per employee of state government, and decreased availability of general fund monies to plan and accomplish repairs and improvements."

The state of Montana was successful in building projects which provide water for agriculture. Many of the original projects still function and the water provided by them is essential to the livelihood of some users.

One of the previous papers given to the Council described the problem of financing spillway repair of state-owned dams. The Board of Natural Resources and Conservation has decided that the state should retain ownership of dam and reservoir projects because the potential liability which could result from a dam failure is too large to be assumed by local water users. Many state-owned reservoirs receive heavy recreational

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use, and provide a small amount of flood control. Continued state ownership of reservoirs is desirable because of these public benefits.

State ownership and management of its canal projects cannot be defended on the same grounds. Liability due to canal failure is small enough that insurance will cover it. Benefits from canal projects accrue only to private water users, again suggesting that private ownership of canals is defensible. The Board has approved a policy of relinquishment of state-owned canals. This paper examines the management of canal projects in order to explain the difficulties involved in implementing that policy. Options for management and disposition of canal projects are presented.

What is a Canal Project?

Projects which have a canal associated with them are called canal projects. There are three types of canal projects owned by the state. Most are delivery canals which are fed by diversion dams. A diversion dam is a structure built across a river to raise the level of the river sufficiently to feed the canal. Very little water is backed up behind the diversion dam; usually water spills over the top because the dams are low. The state owns two pumping plants which lift water from a river to feed a canal. A very few state owned-canal projects consist only of canals.

Table 1 is a list of state-owned canal projects. The list shows active and inactive projects. Active projects are those which require state time and money to administer. Inactive projects have deteriorated to the point they are no longer used. State personnel spend very little time on inactive projects.

Table 1 Active and Inactive Canal Prjects

Active projects are those which are definitelv being used for irrigation. A concerned group (Association) actively operates the active project.

Active Projects with canal systems

- Ackley Lake
- Broadwater-Missouri
- Cataract - private diversion
- Columbus
- Cottonwood - private diversion
- Daly Ditches
- Deadmans Basin
- Delphia Melstone
- Flint Creek
- Fred Burr - private canal system
- Frenchman - private canal system
- Hysham
- Lewistown Ditch
- Little Dry
- Livingston Ditch
- Middle Creek
- Nevada Creek/Nevada North Canal
- Nilan Florence Canal
- Park Branch/Paradise
- Petrolia
- Rock Creek
- Ruby River/West Bench Canal/ Vigilante Canal
- Sidney
- South Side Canal
- Tongue River
- Upper Musselshell
- Willow Creek - private diversions
- Yellowater

Inactive Projects*

- Bainville
- Big Dry
- Hotchkiss
- Lisk Creek
- North Winifred
- Red Butte Creek
- Theboe Lake
- Valentine
- Warhorse

*Inactive projects are those which are deteriorated to the point where use is almost non-existant. The Valentine project is an example.

Operation and Management of Canal Projects

Water users' association and DNRC divide responsibilities for project operation and management. Local users operate projects, while DNRC provides administrative services. The responsibilities of each are discussed in greater detail.

Water Users' Project Responsibilities

In addition to managing the day to day operation of the project users pay operation and maintenance costs of projects. Repairs up to $25,000 are paid by users as well. Any fees charged by consultants to the projects are also paid by the associations. Each users' association carries an individual insurance policy to cover any liability to users which may arise from project failure.

DNRC Administration of Projects

DNRC provides a variety of services to water users associations at no cost to users. Auditing, billing, and accounting for canal projects are done by DNRC employees. DNRC also performs project inspections at least once every one to five years depending on the project. The Department locates consultants to perform work for associations. DNRC has provided some legal services to water users, however, water users have retained attorneys for major legal problems. DNRC has acted as an arbitor in disputes among users, and has represented users on the Columbus project in a disagreement with the Highway Department.

The Department provides technical assistance to water user associations through the Technial Assisatance Program and seed grants through the Renewable Resource Development fund (RRD). DNRC also helps water users find sources of funding for their projects. A rough estimate of the annual cost of DNRC services to users on canal projects is $94,489. Table 2 shows a breakdown of costs between accounting and billing, auditing, and management functions.

Table 2 Anual Costs to the State of Administering Canal Projects

Accounting services:	
Salaries and wages	$22,300
Employee benefits	4,237
Total salaries and benefits	$26,537
Communications	300
Audit expenses	
Per diem (30 associations @ $12.00 per day for 2 days)	720
Travel (30 associations, 400 miles @ 15.5¢/ mile)	1860
Total accounting services cost	$30,417
Engineering and Administrative cost:	
Salaries	$29514
Benefits	5608
Travel and per diem (5 days and nights for 30 associations $12.00 per day and 200 miles @ 15.5¢ per mile)	6450
Total administrative cost	$41572
Total annual cost of all services	$71989

DNRC Contractual Agreement with Water Users

At the time a project is constructed the Department typically executes two contracts with the water users' association. One contract called the water marketing contract is an agreement that the Department will make available a specified amount of water to the water users' association which the association can market. The second type of contract is a three party contract between the Department, the water users' association, and individual users which is called a water purchasing contract. It specifies the amount of water each user wishes to buy and the price which he will pay. In other instances the Department will contract directly with individual user for the sale of water.

Water purchasing contracts run for a term of 30 to 50 years. During this time the price that users pay for a unit of water does not increase. The price per acre-foot is usually calculated by dividing the total cost of the project by the number of acre-feet provided by the project. The operation and maintenance charge is the minimum necessary to pay operation and maintenance on the project.

The Department is bound by the contracts which it executes until such time as the contract expires, comes due for renegotiation for project rehabilitiation, or until both the users and the Department agree that the project has no useful life left and therefore the contract should be nullified. The DNRC can terminate a contract if the provisions of the contract are violated. For instance if users miss payments the DNRC may declare the contract void.

Current Department Policy

In 1978 the DNRC published the Conceptual Plan for Montana Water Resources Projects which was approved by the Board of Natural Resources and Conservation. In the Conceptual Plan the following was stated:

> For canal or pumping projects without significant impoundment, the state should turn title to these projects over to the water users association concerned as soon as the existing project debt is amortized, assuming the project is in reasonably good condition.

This policy was defended on two grounds. First, local ownership of canals is feasible because the liability associated with canal projects is low enough that insurance can reasonably cover any liability to water user associations from canal failure. Second, the Conceptual Plan stated that much Department personnel time is spent on matters which could just as well be handled by the local water users' association.

Existing Implementation of Conceptual Plan Policy

The projects section of the Engineering Bureau has no active program to dispose of canal projects. The general belief of projects section personnel is that it would be good to have such a program, however, it is not enough of a priority to warrant the time required to develop and administer it. Inspite of the lack of an active disposition program, if local users initiate action to get ownership of a canal project the state would consider turning the project over to them.

Since 1971 there have been three attempts to relinquish canals to local water users' associations, however, only one was successful. The attempts to transfer control of projects to local associations originated at the time contract negotiations for project rehabilitation were undertaken between the Department and the water users. The first draft of each proposed contract included a clause specifying that control and ownership of the project would revert to the local water users once the contract had been repaid. Only the Little Dry Water Users' Association accepted ownership. When the existing debt on the Little Dry Project is amortized in 2013 the Association will receive the title to the project.

Process for Turning Over Projects to Local Users

Currently there are two methods which have been used to give local users ownership of canal projects. The first type occurs at the time of contract negotiation for project rehabilitation and the second occurs when the legislature orders DNRC to relinquish ownership of the project--this process is unique to Daly Ditches.

At the time of contract negotiations for project rehabilitation DNRC offers ownership of the project to local users upon retirement of the debt against the project. As previously mentioned only one association in three has accepted this offer. The DNRC must wait until contracts with users expire or until the contract is renegotiated in order to try to give ownership to the water users' associations. Because contracts signed at the time of project construction expire irregularly, and project rehabilitation occurs sporadically, few agreements can be reached with associations regarding ownership of the project. Furthermore, the Department has been successful in getting users to accept repayment of previously unsecured debt against projects during contract renegotiation for porject rehabilitation. Accepting ownership of the project was an additional concession that users were not willing to make. Legal and engineering personnel have other responsibilities which require their attention and do not allow them to become involved in lengthy negotiations.

Although there is no formal policy regarding offers of local users to accept ownership of projects, DNRC would probably consider such an offer. If local associations make such proposals the decision to relinquish canal project would probably follow a process similar to that taken by the Department in disposing of Daly Ditches.

The WRD has been order to dispose of Daly Ditches by the 1979 legislature (MCA 85-1-401). The Department is bound by a contract which specifies

a fixed payment for all project costs. Unlike contracts on other state projects, the Daly Ditches contract does not have a clause which allows the state to increase the operation and maintenance payable by the water users. As a result the project is losing money.

The projects section of the engineering bureau is preparing a terminal report for Daly Ditches which will discuss the present condition of the project structures, the ownership of land served by the project, expected replacement cost of the project, total number of acres irrigated by the project, and the estimated life of the project. The costs of preparing the report is around $75,000; terminal reports for other canal projects would not be as costly.

The projects section is also assisting the users of the Daly Ditches Project in forming an irrigation district. Before the Department can turn over a project, users must form an organization, because DNRC cannot give ownership of a project to an individual. All water users of other canal projects already have local water users' associations so this problem is unique to Daly Ditches.

If the Board or the legislature decided that the state should dispose of a project which the local users did not want, the state would probably attempt to sell the project. The Department does have authoirty to sell projects, however, each sale would be affected by the easements originally granted to project. The state owns some of the land on which its projects were constructed, however, some projects have easements granted to DNRC to build and operate the project. Once the easements are no longer in force, the land may revert back to the original owner in case of sale or abandonment. One legal question which may have bearing is: does selling the project constitute abandonment?

DNRC does not have statutory authority to specify the manner in which a sale must take place. Therefore, sale of the projects would have to follow general realty laws. Real property must be sold by the State Land Board. The sale is advertised in newspapers of general and daily circulation, and sealed bids taken for the project.

If the Department could not sell the project, and the local users did not want it, the project may have to be removed. Individual project easements would dictate what the Department would be required to do. Prior to abandonment, a project would probably have to be made safe.

Problems in Turning Over a Canal Project

Local water users have refused ownership of canal projects for several reasons. Additionally the Department may not wish to indiscriminately relinquish all canal projects.

The most frequent reason that users cite in refusing to accept title to a canal project is the liability associated with a project. Although all users associations currently carry their own insurance policies, they feel more secure knowing that the state still owns the project. As noted before liability associated with a canal project is substantially less than that associated with a reservoir project, and can be reasonably covered by insurance.

Another reason that users desire continued state ownership of canals is due to the arbitor role that DNRC plays when disputes arise among users. DNRC has the authority to enforce its decisions. The Brady project is such an example. The canal supplies a town with water. DNRC does nothing for the project, however, users will not take title to the project because of the possibility of a dispute which they would desire DNRC to arbitrate.

If local users agreed to accept ownership of a canal project, the

association would have to provide all the services that DNRC does now. All accounting, auditing, billing, and project inspections would be the responsibility of the association. Probably the only programs that would still be available from DNRC to associations owning projects would be TAP and RRD. The associations would also have to locate contractors and consultants when needed to arrange for their own financing of large expenditures. Depending on the project, the cost to hire an engineering consultant at $35.00 per hour to manage the project as DNRC does, could run up to $146,000.

The DNRC may not wish to dispose of all structures of a canal project because some of them generate revenue for DNRC. For instance the Broadwater-Missouri project is a canal delivery system fed by a diversion dam which raises the level of the Missouri River. The head on the dam is also sufficient for low head hydroelectric power production. The DNRC would obviously prefer to retain ownership of this canal project because it will be a money-maker for the Department.

There are contractural obligations of the Department which limit its ability to relinquish projects. Because the DNRC is bound by contracts with users, the Department must wait until the contracts expire, need to be renegotiated or users no longer want the project, in order to change ownership provisions of the project. As previously noted this occurs infrequently. Furthermore, contract negotiations have been difficult and the question of accepting ownership of a project is a concession that users have been unwilling to make in most instances.

Options for Management and Ownership of Canal Projects

The following options for ownership and management of canal projects are presented with an accompanying discussion of the possible pros and cons of each. The list is by no means inclusive, there could be permutations of any of the options.

1. The Department could develop a program for active disposition of canal projects which would fulfill the objective of the Conceptual Plan.

To develop and carry out such a plan the Department would have to reorder priorities, unless more persons could be hired to develop and manage the program. The short run costs of this objective could be high, because alot of time would have to be spent in disposing of projects. Each project has a unique set of legal conditions. To actively dispose of projects the projects section would need its own lawyer or all of the time from a DNRC staff lawyer. If the Department could hire extra persons to staff an active disposition program, work on other project section priorities such as spillway rehabilitation would not be delayed. If DNRC had to manage an active disposition program without increased staff, work on other problems of state-owned projects would be delayed until canal projects had been relinquished.

Costs to water users would increase as they gained ownership of projects. Costs to each association would vary according to the condition of the project, the association's inspection program, and the type of consultants hired. It should be noted that many private ditch companies and water users' associations manage quite well on their own without state assistance.

To implement an active disposition program the legislature would have to expand departmental authority. The Department is currently constrained by contracts which are still in effect on some projects. Waiting for renegotiation opportunities to arise at the time of project rehabilitation is too infrequent. Besides as already pointed out, Department staff cannot spend time in the lengthy negotiations which may be necessary to convince local users to accept project ownership.

Legislation which would allow the Department to cancel all outstanding debt against a project could facilitate dispostiion of state-owned canals. Twenty-nine projects have outstanding debt of $4,032,840. (See Table 3) Legislation similar to that which allowed the Department to begin disposition of Daly Ditches would be adequate. One statute governing disposition of the project, MCA 85-1-407, directs the Department to write off or cancel any debts against Daly Ditches. This statute also directs DNRC to "establish procedures for canceling and writing off accounts receivable, and the procedures shall include the reporting of the canceling and writing off of the accounts receivable to the next legislature." If the procedures used to write off the debt against Daly Ditches could be applied to other projects as well, the Department would have the legal edge needed to begin disposing of canal projects.

Table 3 Unamortized Debt on Canal Projects

Project Name	Accounts Receivable
Ackley Lake	$ 21,124
Broadwater-Missouri	42,563
Columbus	64,953
Cottonwood	38,378
Deadman's Basin	408,830
Delphia Melstone	163,056
Flint Creek	46,386
Fred Burr	27,037
Frenchman	98,796
Hysham	360,636
Lewistown Ditch	1,115

Little Dry	33,070
Livingston Ditch	6,100
Middle Creek	46,601
Nevada	77,135
Northside Canal	2,700
Florence Canal	40,560
Park Branch	22,215
Paradise	189,720
Petrolia	387,630
Rock Creek	153,734
Ruby River	42,738
Sydney	443,797
Southside Canal	16,166
Tongue River	678,194
Upper Musselshell	247,422
Willow Creek	34,057
Vigilante	98,782
Yellowater	950
Total accounts receivable	$4,032,840

If the state chose to cancel the debt owed by water users in order to relinquish a canal project, it would lose that portion of its investment. Not all of the outstanding unamortized debt would be written off in one year, however. The state would receive payments from water users for a few more years, reducing the outstanding balance somewhat.

The state would no doubt wish to selectively dispose of canal projects. While canals may not provide marketable benefits, the diversion dams associated with some of them have enough head to generate electricity. The state may wish to clarify that while canals will be turned over to local users, other projects structures may be retained by the state.

2. The Council could endorse the current course of action being followed by the projects section. The section attempts to relinquish projects when the opportunity arises through contract renegotiations for project rehabilitation or when ordered to by the legislature. To continue existing administration and disposition of canal projects the projects section would not require additional manpower or budget--unless four or five projects would require contract renegotiations at once. However, the disposition of projects which are less than optimal is not facilitated by this process. For instance the Department could not have relinquished Daly Ditches under a program which relies on contract negotiations to provide an opportunity to transfer project ownership.

The long run costs of continuing the present methods of canal project disposition could be greater than the short run costs of program to relinquish canals. Under the present operation the Department will continue to provide free services to users' associations and to divide its time between canal and dam projects

Under this option water users would not have to accept ownership of projects when they did not wish to. Users who believe that they are not capable of managing projects will not be forced to do so.

3. The Department could charge water users for the cost of administration of canal projects. The question of who retains ownership could be specified or allowed to remain flexible.

An option which allowed the state to charge for the billing, auditing, accounting, and project inspections would provide a smaller subsidy to water users. It could also allow an economical means of project administration because the state already provides such services at a cost which appears to be less than that charged by private contractors. If the Department could establish an earmarked account for the collection of payments from water users to finance services to canal projects, and yet retain its level of appropriation from the general fund, more effort could be expended on rehabilitating state-owned dams.

Costs to water users would increase under this option. The cost to individual users would vary from project by project depending on the number of users who would be required to pay costs of administration of projects.

4. The council could recommend a study to evaluate the problems of disposing of canal projects. A study would be able to address the problems which are presented in this paper in greater detail. Perhaps more management options could be identified and cost to the state and local water users more tightly defined.

The projects section performs three functions for canal projects--accounting, managerial and engineering, and arbitrating and ownership. A study which addressed these functions in greater detail could produce a more sophisticated array of options. The costs, advantages, and disadvantages of each could be defined more tightly and precisely.